WSDOT Market Analysis

December, 2006

This market analysis is based on a review of published information including the following sources: Associated General Contractors (AGC); American Road & Transportation Builders Association (ARTBA); Energy Information Administration (EIA), Engineering News Record (ENR); Finance and Commerce and the Seattle Daily Journal of Commerce; USA Today.

- **Asphalt** prices will likely rise farther, though at a slower rate than in 2006. Although, crude oil prices have dropped, supply issues will keep asphalt prices high, and could cause supply disruptions in some areas as refineries around the country update their facilities to convert more of the crude oil to gasoline and other more profitable products.

  "Ken Simonson, chief economist with the Associated General Contractors of America, said paving mixtures and related materials could increase 15 to 20 percent in 2007 because of tight supplies and possible shortages. The cost to produce raw asphalt has risen almost 60 percent in the past year, following several years of double-digit increase for the gritty materials. The continued high value of oil gives refineries the incentive to save their refuse and break it down rather than sell it as asphalt, a trend that has some forecasters concerned. The other potential worry comes from abroad, as the re-election of Venezuelan President Hugo Chavez is raising concerns that he will centralize power and make good on threats to cut oil production to the United States. Because Venezuelan crude is very heavy, it is more expensive to refine. So the nation's oil companies sell a large amount of it as asphalt instead, especially in the eastern and southeastern United States. While removing that asphalt from the market wouldn't directly cause shortages in the Midwest, it could drive up the price nationwide." Finance and Commerce, "Highway builders brace for spike in asphalt costs," December 12, 2006.

  "Prices for paving asphalt are expected to increase just 9.4%, after jumping 27.7% in 2006." ENR, "2006 Cost Report," December 18, 2006.

- **Concrete** prices may increase slightly 2007, though price escalation for the material is expected to slow from 2005 and 2006 levels. The threat of shortages has subsided due to imports from China and a trade agreement with Mexico.

  "Cement producers continue to defy tradition by pushing through price hikes during the second half of the year. Before 2005, cement prices were extremely stable, with a modest spring price hike followed by an early summer adjustment. This year, prices have increased steadily through the last four months of the year. This December's 0.9% increase lifted ENR's 20-city average price 7% above a year ago, when it posted a 5%

annual increase. Ready-mix concrete prices have followed a similar trend and are up 6% for the year." ENR, "Construction Economics," December 4, 2006.

"Portland cement is the third materials component of ENR's indexes and cement prices have been increasing at a 12.4% annual rate for the past two years. A surge in imports from China and a new trade deal with Mexico have eliminated the chronic cement shortages of a few years ago. This, coupled with weaker demand from the housing market, will stall further price hikes. Global Insight predicts cement prices will start to fall during the second half of next year, ending 2007 with a 1.2% gain. ENR is forecasting a 3.3% increase it is price." ENR, "2006 Cost Report," December 18, 2006.

- **Fuel** prices decreased at the end of the 2006 due to higher than expected inventories coupled with an unusually warm winter. 2007 average prices are expected to stay below 2006 levels, though OPEC is expected to cut production slightly in the middle of the year, causing a slight price increase.

  "With news that some OPEC countries may be following through with cuts in production, worries of tighter crude oil supplies in the future also drives up demand for crude in the present, as concerns that prices might be higher later encourage more purchasing now. Additionally, concerns about the possibility of a supply disruption in the future have not been eliminated, especially with an upcoming presidential election in Nigeria early next year and recent problems with Iraqi oil production. EIA, "This Week in Petroleum," December 6, 2006.

  "The unusually warm start to this winter kept oil demand depressed below expected levels, resulting in additional inventory cushion and lower prices. But, as expected, once winter weather finally made an appearance along the East Coast, oil demand increased, as did oil prices." EIA, "This Week in Petroleum," February 14, 2007.

  "WTI crude oil, which averaged $66.00 per barrel in 2006, is projected to average about $59.50 per barrel in 2007 and $62.50 per barrel in 2008." EIA, "Short Term Energy Outlook," February 6, 2007.

- **Lumber and plywood** prices continue to decline due to shrinking housing starts. The recent decline of lumber prices is unprecedented. Lumber prices may level out as sawmills nationwide cut back on production and lay off workers to get lumber supplies in line with demand.

  "Lumber prices continue a year-long slump, dropping another 1% in December. That leaves ENR's 20-city average price for the most commonly used species of 2X4s 11% below a year ago. Prices for larger dimension lumber also are down between 6 and 10% over the

last 12 months. Plywood prices held steady after last month's 1% decline, leaving prices 7% below December 2005's level. Gypsum wallboard prices remain strong, despite a weak housing market, and are 10% above a year ago." ENR, "Construction Economics," December 18, 2006.

"Dozens of sawmills around the country are laying off workers, shutting down temporarily or trimming hours, as a steep drop in home building hits demand and prices. New home construction and existing home renovation account for 75 percent of demand for U.S. softwood lumber, which includes pine, spruce and fir. As housing starts have tumbled nearly 30 percent in the past year, some softwood product prices have taken a similar drop. Production at Western sawmills is off 6 percent in the first nine months of the year, and it is expected to fall still more." USA Today, "Building slump hurts lumber market," December 7, 2006.

- **Steel** prices began declining in the fourth quarter of 2006. The outlook for steel prices in 2007 is mixed with some sources predicting a decline and some predicting increases.

  "After heating up for most of the year, steel prices tracked by ENR cooled off in November. The average monthly price decline for channel, wide flange and I-beams was 1.5%, which helped to pull back the year-to-year escalation rate from 11.3% in October to just 6.4%. A year ago, the prices for this group of steel products posted a monthly increase of 2.9%. This November, the largest monthly price declines were 2.7% for wide-flange products and 1.3% for I-beams. Rebar prices also declined 1.7% this month." ENR, "Construction Economics," November 27, 2006.

  "Some of the pricing turnarounds predicted by Global Insight are dramatic. Prices for light structural steel will fall 11.4% next year after climbing nearly 15% in 2006." ENR, "2006 Cost Report," December 18, 2006.

- **Highway Materials & Construction** prices will likely keep rising. In recent years, highway and street construction material inflation has outpaced inflation for other goods. During 2007 prices for materials associated with highway construction will remain elevated, with further escalations possible.

  "The cost of highway and street construction materials grew 5.4 percent in November 2006 compared to the same month last year. Although this increase is significantly less than previous months, it is still above the rate of inflation in the economy." ARTBA, "December 2006 Highway Construction Producer Prices," December 2006.

  "According to AGC's Chief Economist Ken Simonson, since early 2004, the financial viability of all types of construction projects has been jeopardized by sudden, steep, and

generally unanticipated price spikes affecting numerous key materials, " said Massie. "No construction segment has been affected as much as highways." AGC, "Construction News," November 16, 2006.

"We have material price inflation eating more than 30 cents of every dollar in just the last four years and the growing threat that the cost of labor, which has been relatively stagnant over the same four-year period, will begin to rise," warned Massie. AGC, "Construction News," November 16, 2006.

- **Labor** prices are expected to increase double the recent wage trend due to a tight labor market. Contracts set to expire in May could put pressure on projects in Western Washington.

  "The CCI's labor component is forecasted to increase 5.0% next year as ENR's wages for laborers catch up to the 5.0% national average increase reported this year by CLRC. "The driver for inflation is different from what it was two years ago," says Karl Almstead vice president for the Turner Construction Co., New York City. "The uncertainty that we saw in the materials market is being carried over into labor." ENR, "2006 Cost Report," December 18, 2006.

  "On the heels of the disruptive strike last year by concrete plant operators, Western Washington contractors could be facing more trouble this year when a dozen union contracts are up for renewal "I think there's a high likelihood (of a strike) with so many contracts coming due," said Lee Kilcup, CEO of GLY Construction. "We're trying to get as much work done as we can before June first. Several of our clients have expressed concern about the impact of potential work stoppages." Kilcup is part of an Associated General Contractors of Washington team that will negotiate five contracts that expire May 31. The contracts cover about 6,000 carpenters, 6,000 laborers, 5,000 operators, 1,000 cement finishers and 1,000 Teamsters." Seattle Daily Journal of Commerce, "A dozen construction union contracts up for renewal soon," February 1, 2007.